

# PEO Network Articles Archive 1997 (January thru June)

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## Vendor Management Requires Expertise in Many Industries

*Is there a PEO that doesn't outsource most products and services it offers clients? Good vendor management helps improve the bottom line and increases client retention.*

In a perfect world, a PEO could internally provide all the products and services that it has negotiated to deliver to its clients. But, in the real world, a PEO is limited by its internal competencies, and its available cash and facilities. Since few, if any, PEOs have unlimited resources in these areas, most, if not all, are forced to outsource as much as 90 percent of these products and services. Some PEO executives would consider this outsourcing as “practicing what they preach” to their clients. Other PEO executives strive daily to bring as many items in-house as possible. However, the appropriate logic should be that if you don't have the capability to do everything yourself, you need to look outside for help. In any event, most PEOs will usually deal with between 30 and 100 vendors annually to obtain everything they need for their clients. And in dealing with these vendors, a PEO becomes involved with many complex businesses, such as these:

- Payroll and tax administration
- Workers' compensation
- Health insurance
- 401(k)
- Section 125 cafeteria planning
- Risk management
- Third-party claims
- Loss control/safety management
- Labor law compliance
- Human resources consulting
- Management/maintenance of information systems
- Credit unions
- Banking and cash-flow management
- Ancillary insurance products, including: dental, vision, STD, LTD, term life insurance, universal life insurance, cancer/heart attack/ accident indemnity policies
- Buying/discount-buying clubs
- Earned income credit administration
- Courier/delivery services
- Payroll deduction programs, including: home owners and auto insurance, mortgage payments, pre-paid legal services
- Long distance phone services
- Credit card services

Determining which of these businesses or services to keep in-house, and which ones to outsource, is a highly personal challenge, and one that is beyond the scope of this article. The focus here is on assessing and managing the vendors you have decided to use and on establishing sound criteria for choosing new vendors.

When asked about the top three priorities of a PEO, one chief operating officer replied, “Creating a client service model, new sales and vendor management.” Upon further discussion, this COO realized that more than 50 percent of client complaints (those pertaining to the servicing model) came from vendor related problems and that the biggest asset of the sales force was a top rated vendor list. This COO hurriedly put vendor management at the top of his list.

### **Assessing Current Vendors**

There are six basic steps to be taken in evaluating your current vendors and determining which ones need replacing immediately.

**Step 1:** To begin your assessment, ask your accounting department to provide you with a list of all accounts-payable payees in descending order of annual gross payout for the last calendar year (1996). This will give you the total

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number of vendors that you utilize on an annual basis, as well as the amount of revenue you are generating for each vendor.

**Step 2:** Create a financial report that will break down profits by billing module or, better yet, by vendor. For example, if your net profit for 1996 was \$1 million, then where did it come from? A typical breakdown might be \$100,000 from workers' compensation, \$100,000 from health insurance, \$100,000 from state unemployment, \$100,000 from administration activities, etc. The more specific you make this breakdown, the easier the assessment will be.

**Step 3:** Now you must do a survey of your internal employees or, at the very least, of the management team and ask them for their favorite and least-favorite vendors. Have them identify five of each and explain why they've selected them.

**Step 4:** Total up the data from the first three steps in order to determine a list of your top-ten vendors. The weight that you give to each of these steps will be determined by your mission statement, strategic plan, competitive advantage and marketing plan. What all this means is that your top management is ultimately responsible for this list of top-ten vendors.

**Step 5:** This step is best done in a group setting, but time and geography may require that you initiate it alone and then issue it to your key people in the form of a written survey. But, in a group setting, it would be accomplished in this way:

A. Write the vendor's name on an erasable board.

B. Ask: "On a scale of one to ten (with one being the worst and ten the best), where do you rate this vendor, and why?"

C. Average the ratings and then mark the average rating as an "X" on the one-to-ten scale.

D. Next ask the most important question: "What has to happen to make this average rating a ten?"

Step 6: As you review this assessment process, your attention to those vendors with low average ratings will tell you much about those who are candidates for replacement. Those, for example, who are rated at "two" are probably hopeless and will never be able to be elevated to a "ten." Establish a "game plan" to cover the vendors you'll be dropping, and to provide a program for moving fair performers up the scale to a "ten."

## A Case Study

When a certain PEO participated in a recent "management boot camp" seminar, they spent two hours on a limited version of a vendor assessment. With no preparation, they were asked to create a list of the top four vendors, and then use the quality-quantifier process as outlined in Step 5. The president and owner of the company was aghast at the scores given to the top four vendors, companies doing business in these areas:

Workers' Compensation:	6
Health Insurance PPO:	3
Payroll Software:	5
401(k) Plan:	4

The reasons behind the scoring were valid and the action steps created to initiate proper vendor management have been profound and effective. For example, the president thought that he had secured the best 401(k) program on the market and the service provided was superb. In an open forum, during which vendors were discussed, the PEO's director of benefits admitted that, after reading the March issue of *The ProEmp Journal*, he wondered if the investments were "resold" since the share price was not consistent with that on the exchange.

The controller lamented that she had to do all of the vendor's work from an accounting perspective, and noted that she caught many errors when she did this work.

The vice president of client services cited many complaints about the lack of clarity on employee statements.

When I asked this group of ten managers for a show of hands to indicate if they personally participated in the 401(k), the number was embarrassingly low, because they didn't trust the vendor. This is something to think about. Needless to say, this is a vendor who they will be replacing immediately.

## Upgrading Current Vendors

The rule here is simple: treat others as you want to be treated. Write or call each vendor and let them know the

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results of your assessment activities, and tell them about the things your management team would like to see changed. Be sure to take responsibility for your share of the blame for anything that is wrong and needs to be changed. Make sure that plans for resurrecting the relationship are put in writing and include deadlines for the things that must be upgraded. Give the vendor a reasonable amount of time to make corrections, then begin shopping around for a vendor who really wants your business and will make the necessary effort to satisfy your requirements. In the case study described earlier, even though the payroll vendor's score was a "five", the PEO's management felt they had invested thousands of dollars in software and upgrades and it was worth salvaging this vendor. The first step in doing this was a letter sent from the PEO's president to the owner of the payroll vendor company to discuss the need for improvement. Secondly, the MIS director followed up with a 45-minute phone call to outline specifically each area of concern. In addition, the MIS director admitted his lack of participation in training programs and promised to increase attendance. Because of this discussion, the relationship rating has recently skyrocketed to a "nine."

### **Vendor Selection**

When selecting new vendors, there are many important variables to consider. Among them are these:

- Does the vendor match your "competitive advantage? Are you a least-cost provider or a value-added service provider? Pick a vendor who is compatible with your corporate philosophy. Mixing competitive advantages is a recipe for disaster because the vendor's service level will not be what is expected or needed.
- Spend twice as much time with the team that will service your account versus the team that is selling you the product/ service.
- Find out if vendors actually know anything about the PEO industry. Create a simple quiz to administer to each vendor employee who will interface with your PEO. It's imperative for them to understand they have not landed a 5,000 employee account. Instead, they have acquired 400 small accounts totaling 5,000 worksite employees spread across 26 states.
- Have each vendor give you a written service agreement. This agreement should encompass a description of their services, and an indication that they understand your business as a PEO. It must also stipulate the rewards established for outstanding service, and the consequences of unacceptable levels of service. Keep in mind that it will reduce costs to the PEO, and increase chances of enforceability, if the vendor presents the PEO with the contract.

### **Managing Existing Vendors**

There are 6,573,125 private businesses in the U.S., according to the Bureau of Labor Statistics, and only 5,282 have more than 1,000 employees. PEOs are an elite group that bundles hundreds of small businesses together to leverage the law of large numbers and to offer dilution of risk. Convert that leverage into long-term strategic alliances with top vendors.

Managing from 30 to as many as 100 vendor relationships can be a time-consuming process, especially since one vendor can encompass several departments simultaneously. A few PEOs have an actual job description for a "vendor manager," however most assign the duties to the various department heads.

The easiest way to manage vendors would be through a quarterly, or at least an annual, "PEO vendor forum" (PVF). The most important outcome would be to save time and money by telling one story to many vendors simultaneously. You might want to think of the PVF as an annual "stockholders meeting," where you talk about past performance, future growth plans and how your vendors fit in. However, any constructive criticism of a specific vendor should be kept to a private meeting.

You might want to stage a "vendor of the year award" program. The expense and time you devote to this and to other aspects of your PVF should reflect the importance you place on vendor management and the role that good vendors play in the success of your company.

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